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UNCLAS SECTION 01 OF 02 YEREVAN 002224

SIPDIS

SENSITIVE

STATE FOR EUR/CACEN FOR SIDEREAS, EUR/ACE FOR LONGI, EB/ESC,  
PASS TO USAID EGAT FOR WALTER HALL

E.O. 12958: N/A

TAGS: [ECON](#) [ENRG](#) [AM](#)

SUBJECT: ARMENIAN GOVERNMENT GIVES ENERGY SECTOR A HALF-FIX

Ref: YEREVAN 1453

1. (U) This cable is sensitive but unclassified. Please protect accordingly.

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SUMMARY  
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2. (SBU) On October 1, Armenia's Public Service Regulatory Commission (PRSC) ended ArmEnergo's reign as the state-owned single buyer of midstream electricity, responding to demands of the donor community (including the United States as part of the most recent US-Armenia Task Force action plan). The GOAM has fulfilled only part of its obligation: it has failed, however, to implement the necessary market rules and energy cost adjustment mechanisms to protect the energy market from price instability and rent seeking. Without such measures, the dissolution of ArmEnergo makes the private energy distributor and generating companies part of a market without rules and no secured payment mechanism. It is unclear what will happen if energy input prices rise, but the distributor has no right to pass costs onto consumers. Sources from the Ministry of Energy point out that the Ministry maintained significant control of Armenia's energy sector through its ownership of the Vorotan Cascade, Armenia's largest hydro-electric plant, Transmission Network and Power System Operation. End Summary.

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WHAT HAPPENS NOW?  
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3. (SBU) Until last week, ArmEnergo acted as a single-buyer single-seller mediator of electricity, in effect making the Government of Armenia the guarantor of the Armenian energy sector. The Ministry of Energy used ArmEnergo to keep end-use prices stable when generation costs fluctuated. Now the privately owned electricity distributor, Electricity Networks of Armenia (ElNetArm) must take over the financial responsibility for the sector. This basically has shifted the single-buyer responsibility from ArmEnergo to ElNetArm, who currently must provide electricity at regulated tariffs even if costs rise. The Public Service Regulatory Commission (PSRC) has failed to establish an energy adjustment fund or adopt an adjustment clause, which would give the distributor the right to raise electricity prices for end-users, upon PSRC's review, when the average generation costs rise. The PSRC has prepared a draft Law to provide the mechanism for funds flow and tariff adjustment; we expect this will come before the National Assembly in October.

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MINISTRY TO KEEP CONTROL?  
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4. (SBU) Sources close to the Ministry of Energy say that the Ministry intends to maintain its control of the market through its ownership of the Vorotan Cascade, a hydro-plant that supplies nearly 20 percent of the energy market. Because hydroelectricity makes up the cheapest share of Armenia's energy, the government has the flexibility to use Vorotan's output to trade electricity and influence over-all energy costs to the distributor. The government's control of Vorotan also presents opportunities for profits: the GOAM is currently exporting the plant's cheap electricity to Iran, to pay the debt on constructing a new transmission line and for a substation upgrade used for transactions with Iran. (Note: Normally Armenia would "bank" this energy in an energy swap where Armenia exports electricity in the summer to Iran and imports electricity in the winter from Iran. End Note.) The Ministry of Energy's project will likely increase Armenia's need for higher-priced electricity (generated in gas-fired plants), for which consumers will ultimately pay significantly higher prices.

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COMMENT: REMOVAL OF ARMENERGO NECESSARY BUT NOT SUFFICIENT  
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15. (SBU) International donors have long sought to separate ArmEnergo and the Ministry's functions as a supplier of electricity in order to reduce the capacity for corruption in the energy sector. But the Ministry is reluctant to cede complete control of the energy sector to private enterprises. The removal of ArmEnergo is a necessary but not sufficient step to withdrawing the Ministry from the energy sector. Until the Public Service Regulatory Commission establishes market rules governing private (as well as public) actors as well as some safeguards to deal with energy supply and financial settlements, there will not be a viable private energy market. For now the Ministry's involvement in the energy sector will continue to create opportunities for rent seeking by those who control the government's energy assets.

RICHTER